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SUBJECT: OPPOSITION STATES AND MUNICIPALITIES SURVIVING FINANCIALLY, FOR NOW

REF: A. 2008 CARACAS 1453
[¶](#)B. CARACAS 445

Classified By: Economic Counselor Darnall Steuart, for reasons 1.4 (b) and (d).

[¶](#)1. (SBU) Summary: With the significant exception of the Alcaldia Mayor (Mayor of Metropolitan Caracas), states and municipalities won by opposition candidates in the November 2008 elections appear to be weathering significant budget cuts forced by central government action, particularly changes in the government's 2009 budget. The Government of the Bolivarian Republic of Venezuela (GBRV) has not to date made extensive use of other tools at its disposal to restrict the resources flowing to opposition-controlled areas. End summary.

Regional Public Finance: Dependent Decentralization

[¶](#)2. (SBU) As noted in ref A, the Government of the Bolivarian Republic of Venezuela (GBRV) has developed a variety of tools it could use to restrict the resources available to states and municipalities. States, which have very limited authority to raise taxes, depend almost entirely on constitutionally-mandated transfers from the central government. The most significant of these transfers is known as the "situado constitucional," which obligates the central government to transfer 15 to 20 percent of estimated ordinary revenue. Although they have greater authority to raise taxes, many municipalities, particularly those covering less prosperous areas, also rely almost entirely on these transfers. Tools at the GBRV's disposal to restrict resources available to states and municipalities include diversion of ordinary revenue to quasi-fiscal funds (thus reducing the mandated transfers), changing estimates of ordinary revenue, changing revenue streams from ordinary to extraordinary, and, at the most extreme, appointing "regional authorities" and diverting central government transfers from states and municipalities to these new authorities.

Budgets Take a Hit

[¶](#)3. (SBU) The GBRV has taken two broad steps since the November 2008 elections that reduce the income of many states and municipalities. On March 12, the National Assembly passed a law giving President Chavez the authority to take

control of ports and airports from state governments, an authority he has exercised in states controlled by opposition governors. Then, on March 21, Chavez announced revisions to the 2009 central government budget which reduced estimated ordinary revenues. The first of these steps, while significant from a political perspective, has not had a major impact on state budgets. In Valencia, home to Puerto Cabello, Venezuela's largest port, state officials told Econoff that Puerto Cabello represented less than 4 percent of the state's revenue.

¶4. (C) The budget revision has had a far greater impact on state and many municipal budgets. While the revised budget has not been published, our contacts report the net decrease in estimated ordinary income is roughly 21 percent. Thus, central government transfers to states and municipalities deriving from the situado will be reduced by this amount. Taking into account the situado reduction (which the central government is retroactively applying with a 28 percent reduction starting in April or May) and other changes, the deputy governors of Miranda and Carabobo (strictly protect throughout) separately estimated to Econoffs their budget for the rest of the year would be 27 to 28 percent lower than anticipated. (Note: Miranda's deputy governor said the state's original 2009 budget was roughly the same as the effective 2008 budget. End note.)

Impact of the Budget Revision

¶5. (C) With inflation at close to 30 percent, one would think a budget cut of 27 percent would be disastrous for

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states and many municipalities. Miranda's deputy governor, however, said the state would be able to provide better services in 2009 than it did in 2008, as the previous administration was so inefficient and corrupt. She said Miranda had raised salaries for teachers and police by 40 percent, a raise made possible in part by eliminating salaries of many "contract workers" put on the payroll by the previous administration. Carabobo's deputy governor and economic secretary said the state would have to cut some services and would likely have to lay off some workers, but would have the resources to fund social spending priorities. Both deputy governors noted poorer municipalities, almost completely dependent on central government transfers and often poorly administered, would suffer the most from the budget revision. In both states, these municipalities tend to be run by Chavista mayors. On the other hand, wealthier municipalities such as Chacao and even Sucre (both part of metropolitan Caracas and run by opposition mayors) have generally not been so hard hit. Sucre officials told Poloff the municipality's tax revenues had increased between 30 and 40 percent year-on-year, more than compensating for the cut in central government transfers (which make up less than 10 percent of Sucre's budget). The officials speculated some businesses might be more inclined to pay taxes to the current municipal administration than they were to the previous Chavista administration.

¶6. (C) The central government has several ways of compensating specific mayors or governors for the broad budget cut, if it chooses. The National Assembly can approve "additional credits," which can be transferred to specific mayors or governors through the Interior Ministry or which can be used for projects in a given state or municipality run by a central government ministry. A review of state or municipality-specific projects receiving additional credits suggests, not surprisingly, they tend to be in Chavista-controlled jurisdictions, although the amounts are not great. Secondly, Chavez can order off-budget transfers or projects financed by a variety of discretionary quasi-fiscal funds. As these funds lack transparency, there is no way of evaluating this mechanism.

Specific Moves

17. (SBU) In contrast to the budget revision, which affects all states and municipalities, the GBRV specifically targeted the budget of the opposition mayor of Metropolitan Caracas (Alcaldia Mayor) in the course of promulgating a law creating a new Vice President of the Republic for Caracas (ref B). With respect to the situado constitucional, the Alcaldia Mayor was treated as if it were the state corresponding to the Libertador municipality. (Note: Libertador is the largest of the five metropolitan Caracas municipalities. Whereas the other four are part of Miranda state, Libertador does not fall within any state. The new Vice President oversees only Libertador municipality. End note.) While the Alcaldia Mayor was also supposed to receive 10 percent of the revenue collected by each of the five municipalities, in practice the municipalities resisted transferring this revenue, and our contacts estimate that over 90 percent of the Alcaldia Mayor's revenue came from the situado. The new law gave control over the situado to the new Vice President, thus stripping the Alcaldia Mayor of almost all its financial resources.

18. (SBU) Another recent GBRV action which will have a large impact on the finances of specific municipalities is the expropriation of selected oilfield service providers. As PDVSA, the new owner of these businesses, is exempt from paying municipal tax, the expropriation will result in significant losses to municipalities where these providers were based. Some have interpreted these expropriations as an attempt to undermine the economy of Zulia state, an opposition stronghold and site of many of the expropriated companies. While this interpretation may have some basis, one contact told Econoff the immediate, direct fiscal impact is likely to hurt Chavista mayors in the municipalities on the east side of Lake Maracaibo more than the opposition mayor of Maracaibo (and certainly more than the opposition governor of Zulia, as the state cannot raise taxes).

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Comment

19. (C) President Chavez has amassed an extensive toolbox through which he can restrict finances to opposition governors and mayors. He has used several of these tools since the November 2008 regional elections, which saw a number of significant posts - including Mayor of Metropolitan Caracas, Governor of Miranda, Governor of Carabobo, Mayor of Sucre, and Mayor of Maracaibo - pass from Chavistas to opposition leaders. The fact that the most significant of GBRV actions to date, namely the budget revision, also impacts Chavista governors and mayors is not surprising, as it serves to remind them of their dependence on Chavez. We expect additional selective application of these tools in the future, as Chavez gauges the extent to which he can use them without a political backlash. End comment.

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